EU AGREEMENT ON PROPOSALS FOR THE SCREENING OF FOREIGN DIRECT INVESTMENTS INTO THE EU

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Legal Briefings

On 20 November 2018 negotiators representing the three European institutions (the Parliament, the Council and the Commission) agreed on a new co-operation mechanism for the review of foreign investment in EU Member States. The agreement is based on a draft Regulation setting out the proposal as announced in September 2017. See our e-bulletin here.

This development comes at a time when we are seeing the Governments of traditionally open economies adopt increasingly protectionist rhetoric when it comes to foreign investment. We have seen a toughening in stance across individual EU Member States (including Germany, France and the UK) as well as in the US and Australia. For more analysis on this global trend see our joint paper with Global Counsel available here.

We consider below some of the key workings of the proposed framework including:

- the extent to which we can expect to see an alignment in
approach across Member State reviews of foreign investment;

• when and to what extent the Commission and other Member States will be able to intervene; and

• the interaction of the proposed framework with European merger control.

We have also set out what the next steps will be as the draft Regulation is formally approved and provide some initial comment on the impact of the proposed framework.

BACKGROUND

The proposed framework will provide a mechanism under which the Commission can intervene when foreign investment in a Member State may give rise to public order or security concerns. The mechanism for screening foreign investment largely stems from the Commission proposal unveiled in September 2017, although a number of additions to the draft Regulation have been agreed (as highlighted below in italics). We expect to see a revised draft Regulation in the coming weeks. This will then be subject to the full co-legislative process (requiring formal approval from the Parliament and Council) before it comes into force.

ESTABLISHING A COMMON APPROACH TO FOREIGN INVESTMENT REVIEW

The proposed framework does not require Member States to adopt a fully harmonised approach to foreign direct investment. It does, however, require existing (and any new) regimes to comply with a minimum set of requirements.

• Screening factors – the framework sets out a non-exhaustive list of factors that Member States may consider when assessing foreign direct investment. This includes potential effects on critical infrastructure (e.g. energy, transport, communications etc.), critical technologies, security of supply and critical inputs and access to/control of sensitive information. Member States may also take into account whether the foreign investor is controlled by a third party Government, for example, through significant funding. We understand that the above sectors have been expanded in the negotiations and may now also include media, land and real estate, water-supply infrastructure, data processing and electoral infrastructure.

• Screening mechanisms – the framework requires Member States to be transparent as
to when transactions and/or investments will be subject to review and the procedure that will apply. This must include a right to appeal and, interestingly, places an obligation on Member States not to discriminate between different third countries.

- **Reporting obligation** – this includes an upfront requirement to notify the Commission of the domestic regime (and any subsequent changes) alongside an annual reporting obligation on the application of the regime. This must include details of the transaction screened, prohibitions and conditions imposed, the value of screened investment and its origin. For Member States that do not have a domestic screening regime, they will still be required to provide an annual report on the foreign investment that has taken place in the reporting year.

**INTERVENTION BY THE COMMISSION OR BY OTHER MEMBER STATES**

The Commission will be able to issue an opinion on foreign direct investments that are likely to affect EU projects and programmes on grounds of security and public order (e.g. Galileo). *It may do this of its own accord or (following the negotiations) where a third of Member States (i.e. 9) raise a concern.* It is in this circumstance that the Commission will itself screen the investment in accordance with the Regulation. Where the Commission issues an opinion to the reviewing Member State it must take the utmost account of it (and must provide an explanation where it does not follow the Commission opinion).

In addition, the draft Regulation provides that the Commission and Member States may provide comments to a reviewing Member State under the co-operation mechanism where a foreign investment is likely to affect security or public order in one or more Member States. This would not amount to a full screening by the Commission (despite being unhelpfully referred to as an "opinion" in the draft Regulation). Where the effect of an investment is not linked to an EU project or programme the reviewing Member State will be bound only by a need to "give due consideration" to the Commission opinion (or Member State comments) and will not have to explain any deviation in approach.

In both instances the reviewing Member State retains the final decision-making power regarding the foreign direct investment.

**REVIEWING MEMBER STATE AS THE FINAL DECISION MAKER**

The European foreign investment framework is not intended to replace existing domestic foreign investment regimes. The regime is essentially one of information sharing, collaboration and peer pressure. Member States retain sovereignty of decision making, although the Commission is clearly targeting alignment through a discursive approach. In practice, it can be expected that there will be investments, sectors and individual Member States that will not be swayed by Commission/wider Member State concerns. This will not be as simple as larger states versus smaller, as the latter may find themselves in a position where inward foreign investment is essential to their economies. For Member States which do not have foreign investment regimes, it remains to be seen whether this framework will encourage them to introduce domestic reviews and whether soft law alignment of approach will be facilitated.
FOREIGN DIRECT INVESTMENT AND EUROPEAN MERGER CONTROL

The EU Merger Regulation (EUMR) does not allow for political considerations to be taken into account as part of the merger review process, but allows Member States to take appropriate measures to protect legitimate interests in respect of a transaction that qualifies under the EUMR (Article 21(4) EUMR). The provision expressly recognises the protection of public security, plurality of the media and prudential rules as legitimate interests, but any other public interests must be communicated to the Commission and must be recognised by the Commission as compatible with the general principles of EU law before the Member State can take any measures.

The proposed framework will not change this position but it does open the way for dual influence from the Commission: (i) as the substantive decision maker for competition issues and (ii) through a non-binding advisory opinion where countries seek to review the transaction domestically, to protect its legitimate interests. However, the regimes will remain fully independent. It has been reported that the informal agreement across institution negotiators includes an 18 month long-stop period in which completed investments could be reviewed. It is not yet clear how this is intended to operate in practice and, where national regimes currently have a shorter period, adjustments will be needed.

NEXT STEPS AND TIMING

Now that we have agreement at negotiator level between the three institutions, the next step is for the draft Regulation to be revised and then approved through the co-legislative procedure. This will involve formal approval from both the European Parliament and the Council. The Commission has been targeting the end of the current parliamentary term (May 2019) as a longstop for getting the proposals agreed. There is currently no definitive timetable set down for the legislative process and, following formal approval, there will need to be a grace period for Member States to make any necessary changes to domestic regimes (largely in terms of procedure). Based on current projections and commentary we do not expect the final Regulation to come into force before spring/summer 2020.

In parallel to the formal process the Commission is currently analysing foreign investment flows into the EU and has set up a coordination group with Member States as a forum for identifying where concerns and solutions may lie in relation to foreign investment.

COMMENT

A common argument against foreign investment regimes has been the extent to which they provide a backdoor mechanism for Governments/institutions to intervene to protect broader social, economic and political interests. The proposed framework does not premise itself as a mechanism for protecting only European security. It is a regime that seeks to protect both security and public order across Europe. President Junker has stated, in response to agreement on the current proposal, that "Europe must always defend its strategic interests...[W]e need scrutiny over purchases by foreign companies that target Europe's strategic assets..."
Any concern related to political interference by the Commission should not be overstated in this context given that the ultimate decision on investment will rest with the reviewing Member State. It is also not a new phenomenon that the Commission and individual Member States have varying degrees of political and economic influence over the direction of European policy and intervention. Going forward, it will be interesting to see the type of investments that the Commission and other Member States will seek to influence under the new framework and how much weight this will carry for reviewing Member States.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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